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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. 123

OKEMAH NATIONAL BANK, a Corporation, PETITIONER

v.

EARL R. WISEMAN, District Director of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 6-7, Pet. App. i) are not officially reported. The opinion of the Court of Appeals (Pet. App. ii-vi) is reported at 253 F. 2d 223.

JURISDICTION

The judgment of the Court of Appeals was entered March 10, 1958. (Tr. 12.) Rehearing was denied April 11, 1958. (Tr. 30.) The petition for certiorari was filed on June 23, 1958. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Whether the record warrants the District Court's determination, affirmed by the court below, that amounts paid by the taxpayer corporation (a bank), in satisfaction of a personal judgment rendered against its president and for attorneys' fees incurred in the litigation culminating in the judgment, were not deductible as ordinary and necessary expenses of the taxpayer corporation under Section 23(a)(1)(A) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*——

(1) *Trade or business expenses.*——

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.23(a)-1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly con-

nected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. * * *

STATEMENT

This case arises out of a suit by the petitioner, Okemah National Bank, for a refund of 1950 income taxes in the sum of $8,479.98, based on a claim that amounts paid by the bank on the personal liability of its president, as surety for the trustees of an individual trust, and deducted from the bank's gross income, were erroneously disallowed by the Commissioner of Internal Revenue. (R. 1-3.) The case was heard on a stipulation of facts (R. 20-23) and testimony (R. 8-19).

In 1925, Martin, Chowning, and Randles were the officers, directors and majority stockholders of the bank. Martin, the president, executed a surety bond covering the trustees of a trust in favor of two Indians. Chowning and Randles agreed to reimburse Martin for any payments he might have to make on the bond, and the three men divided the premiums paid for the bond. The bank did not receive any premiums. During the period of the bond from 1925 to 1929, the trust funds were deposited in the bank and amounted to 2.75% to 3.88% of the bank's total demand deposits. When the suretyship ended, the trust funds were removed to another bank.

In 1940, the beneficiaries of the trust sued the trustees, Martin, Chowning, Randles and the bank for alleged conspiracy to defraud and fraud in the handling of the trust funds. The bank, Chowning and Randles were dismissed from the action, which proceeded

against Martin alone, one trustee being deceased and the other financially irresponsible. In 1950, the court found no fraud or conspiracy, but did find improvident management on the part of the trustees and held Martin liable on his surety bond for the loss suffered by the trust in the sum of $14,000. The bank paid the $14,000 judgment against Martin plus $2,199.99 for attorneys fees and court costs incurred in the defense of the action.

The testimony related to the bank's claim that, in order to secure for itself the benefit of the deposit of the trust funds, it had agreed to reimburse Martin for any liability incurred by him on the surety bond. There was, however, no such written agreement and no minutes of any such agreement, and the testimony of the bank directors as to the existence of an oral agreement for reimbursement or guaranty by the bank was conflicting. (R. 15, 16-17, 18.) The District Court found in favor of the defendant and dismissed the action. (R. 6-7.) The Court of Appeals affirmed. (Pet. App. ii-vi.)

ARGUMENT

The decision below is correct, and there is no conflict. This case presents a question of fact, and the concurrent findings of both courts below, amply supported by the record, do not warrant further review.

1. Section 23(a)(1)(A) of the Internal Revenue Code of 1939, *supra,* p. 2, limits deductible business expenses to "ordinary and necessary" expenses paid or incurred in carrying on the taxpayer's business. See also Section 29.23(a)-1 of Treasury Regulations 111, *supra,* pp. 2-3. The general principles for determining whether a business expense qualifies for deduction

under that section are settled. The expense must be both ordinary and necessary in relation to the kind of business in which the taxpayer is engaged; to be "ordinary", it must be normal or customary, in the sense that it is of common or frequent occurrence in the kind of business involved; and whether a claimed business expense deduction meets these tests turns upon the particular facts of each case. *Welch* v. *Helvering,* 290 U.S. 111; *Deputy* v. *du Pont,* 308 U.S. 488; *Commissioner* v. *Heininger,* 320 U.S. 467.

The record fully warrants the trial court's conclusion, affirmed by the court below, that the expenditure here in question—amounts paid by a banking corporation to satisfy a personal judgment rendered against its president as a surety for trustees, on account of a breach of the trust, and to defray the legal expenses in defending the lawsuit which led to the judgment—was not an "ordinary and necessary" expense incurred in carrying on a banking business. As the court below pointed out (Pet. App. iv-v), the taxpayer bank was not even obligated to make the payment, and it is established that a voluntary payment of another's debt is not deductible as an ordinary and necessary business expense. *Welch* v. *Helvering, supra; Ecco High Frequency Corp.* v. *Commissioner,* 167 F. 2d 583 (C.A. 2d), certiorari denied, 335 U.S. 825; *Hales-Mullaly, Inc.,* v. *Commissioner,* 131 F. 2d 509 (C.A. 10th); *A. Giurlani & Bro.* v. *Commissioner,* 119 F. 2d 852 (C.A. 9th). Even assuming, as taxpayer insists (Pet. 11-13), that it contractually obligated itself to make the payment, "The mere fact that the expense was incurred under contractual obligation does not of course make it the equivalent of a rightful deduction under § 23(a)."

Interstate Transit Lines v. *Commissioner*, 319 U.S. 590, 594. See also *Deputy* v. *du Pont, supra* p. 496. Nor did the business necessity or expediency of incurring the expense, or even the fact that it proved beneficial, qualify it for deduction, as taxpayer also assumes. "For Congress has not decreed that all necessary expenses may be deducted. Though plainly necessary they cannot be allowed unless they are also ordinary." *Deputy* v. *du Pont, supra*, p. 497. This means that (p. 495) "the transaction which gives rise to it must be of common or frequent occurrence in the type of business involved." See also *Welch* v. *Helvering, supra*, p. 114. As the court below observed (Pet. App. v-vi), the expense in question, far from being the kind commonly or customarily incurred by banks, "was extraordinary and fell well outside the perimeter of conventional bank practices." See also 7 Michie, *Banks and Banking* (1944), c. 15, Sec. 163.[1]

2. There is no basis for taxpayer's assertion (Pet. 9) that the decision below conflicts with *Welch* v. *Helvering*, 290 U.S. 111, and *Commissioner* v. *Heininger*, 320 U.S. 467. As is plain from its opinion, the court below applied the principles enunciated in those cases to the facts of this case. Its decision is in complete accord with that in the *Welch* case, where payments by a taxpayer to creditors of a bankrupt corporation of which he had been an officer, in order to reestablish his credit relations with former customers, were held not

[1] The state court decisions upon which taxpayer relies (Pet. 11) merely stand for the proposition that a banking or other corporation may be liable on a contract where it has received benefits therefrom even though the contract is *ultra vires* and "outside of its legitimate business." See, *e.g.*, *Crowder State Bank* v. *Aetna Powder Co.*, 41 Okla. 394.

to be "ordinary," notwithstanding that they were necessary for the development of the taxpayer's business. In the *Heininger* case, litigation expenses incurred by the taxpayer in defending his business against threatened destruction were held to be deductible as ordinary and necessary business expenses, and the case turns on its own clearly distinguishable facts. This Court there reiterated that (p. 475) "Whether an expenditure is directly related to a business or whether it is ordinary and necessary are doubtless pure questions of fact in most instances."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JULY, 1958.

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